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BEFORE THE
Federal Communications Commission
WASHINGTON, D.C.

In the Matter of	)	
	)	
Amendment to The Bell Atlantic Telephone Companies Tariff FCC No. 10	)))	Transmittal Nos. 741, 786 Amended
	)	CC Docket No. 95-145
Video Dialtone Service	)	

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OPPOSITION TO DIRECT CASE

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OPPOSITION TO DIRECT CASE

The National Cable Television Association, Inc. ("NCTA"), by its attorneys, hereby files its Opposition to the Direct Case filed pursuant to the Bureau's Order Designating Issues for Investigation in the above-captioned proceeding.[1]

INTRODUCTION AND SUMMARY

Having put off the decisions until sometime next year that it should have resolved last year, the Commission is now investigating the tariff rates that Bell Atlantic intends to charge for its video dialtone ("VDT") service in Dover Township, New Jersey. These rates are unlawful. Appropriate rates should be prescribed.

Bell Atlantic has constructed its system and is apparently planning to offer service soon. The company will be charging predatory rates in Dover Township because the Commission has repeatedly refused to decide whether the system is likely to

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[1] See Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates Terms and Regulations for Video Dialtone Service in Dover Township, New Jersey, Transmittal Nos. 741, 786, CC Docket No. 95-145, Order Designating Issues for Investigation (released September 8, 1995) ("Designation Order").

cover its costs. At the Section 214 stage, the Commission relied on its broad discretion to avoid a careful examination of an extraordinarily weak economic showing. At the tariff stage, all the Commission was able to find was that the tariff was not unlawful on its face. Meanwhile, judicial review of the underlying Section 214 ruling has been delayed, and motions for stay filed with the Commission more than fifteen months ago still have not been acted upon.

It has been obvious since the Section 214 application was filed three years ago that Bell Atlantic's service will be cross-subsidized by telephone ratepayers unless the Commission acts. Dr. Leland L. Johnson, in an analysis which is appended to this "Opposition,"[2] finds that Bell Atlantic will have to charge video programmers in Dover Township twice the tariff rates it intends to charge in order to cover the costs of its service. Permitting the existing rates to stay in effect following this investigation is not, as a result, an option. Prompt action to conclude this investigation and to adjust the authorized rates to properly reflect the service's costs is an absolute necessity. It is equally essential that the Commission remedy unreasonable terms and conditions of the Dover tariff that permit Bell Atlantic to discriminate in favor of its affiliated programmers.

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[2] See Declaration of Leland L. Johnson, Ph.D., attached as Appendix A to this pleading ("Johnson Declaration").

As to the rates, Dr. Johnson identifies three fundamental errors in the subject tariff. First, Bell Atlantic intends to charge telephone customers a substantial portion of the cost of the integrated network, even though most of the cost of the network is properly allocated to video dialtone. Dr. Johnson observes that 67% of the cost per subscriber is assigned by Bell Atlantic to telephone, and only 33% is assigned to video. But there is no economic basis for this assignment.

Second, Bell Atlantic classifies "overhead costs," which constitute an amount approximately two-thirds as great as direct costs, as a fixed cost. The company then claims that the allocation of these fixed costs between telephony and video is arbitrary, and that its arbitrary assignment of only a 20% percent overhead loading factor to video is properly within its discretion. Dr. Johnson demonstrates that overhead is a variable cost; i.e., overhead costs increase in proportion to the direct costs of telephone and video. Since overhead costs increase in proportion to direct costs, they should be assigned proportionately to the cost causative service. Since each dollar of direct investment in VDT (or any other service) generates 65 cents of overhead, it follows that the 20% overhead loading factor should be increased to 65%.

Finally, prompt Commission action is particularly needed because Bell Atlantic has gotten this far only through subterfuge. The company has maintained throughout that the incentive regulation scheme adopted by New Jersey will prevent cross-subsidy. But as Dr. Johnson demonstrates, neither the New Jersey incentive regulation scheme, nor the Commission's existing or proposed price cap plans, will effectively break the link between prices and costs, and thereby remove Bell Atlantic's incentive to cross-subsidize its video dialtone service. With the incentive to cross-subsidize still present, Dr. Johnson's conclusion that VDT rates are understated by one-half is of particular moment.

Bell Atlantic's tariff is a remnant of a dying policy initiative. Pending telecommunications legislation may retain a form of common carrier video delivery, and some companies may offer it, but the format under which Bell Atlantic claims it will operate in Dover raises significant problems. Nevertheless, since Bell Atlantic is still claiming that it plans to proceed, the Commission has no choice but to adjudicate the issues raised by this tariff to ensure that the rates, terms and conditions of the service offering comply with the statute's requirements.

Proper adjudication must result in prescription of rates that cover costs in line with this pleading and Dr. Johnson's Declaration. The Commission must also remove the other terms and conditions of the Dover tariff that, as explained below, are unjust and unreasonable.

DISCUSSION

I. THE DOVER TARIFF INVESTIGATION IS THE LAST CHANCE TO PROTECT TELEPHONE RATEPAYERS FROM SUBSIDIZING THE DOVER SYSTEM.

Throughout the FCC's VDT proceedings, the cable industry has asked that the Commission establish a coherent policy for allocating the costs of this massive facilities upgrade. Yet despite recognizing early on in the proceedings that VDT raised serious allocation problems, the Commission has repeatedly avoided the issue. Having missed so many opportunities to address the matter, this tariff investigation proceeding is now the last chance to address the cross-subsidy of the Dover VDT service.

As early as its initial Notice of Inquiry in the VDT proceedings,[3] the Commission acknowledged that "telephone companies potentially could engage in anticompetitive conduct . . . by imposing added costs on the monopoly ratepayer by cross-subsidizing such new broadband services."[4] Subsequently, the Commission sought more detailed comment on these issues:

> [A]s video dialtone is deployed, some changes in our rules regarding accounting, cost recovery, jurisdictional separations, pricing and access charges may be appropriate. For example, it may be that specific additions to our current Part 69 rate elements may be necessary or desirable. We therefore ask commenting parties to identify issues they believe will arise as video dialtone develops that may require some

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[3] See Telephone Company-Cable Television Cross-Ownership Rules, Notice of Proposed Rulemaking, 2 F.C.C.R. 5092 (1987).

[4] Id. at 5093.

regulatory response at some future time.[5]

The Commission went on to ask specifically for comment regarding whether changes in "Part 32, Part 64, Part 36 or Part 69 will be necessary to accommodate the proposals we are making here."[6]

In response, NCTA asked the Commission to establish VDT-specific safeguards to prevent cross-subsidy of VDT investment and other improper practices.[7] In the VDT Order, the FCC acknowledged that it may be necessary to promulgate additional safeguards for VDT. The Commission refused, however, to make the necessary changes at that time and chose instead to rely on then existing telephone regulations:

> We are aware that some potential for abuse exists with respect to the offering of video dialtone. Moreover, we expressly recognize that, due to developing technology and uncertain consumer needs, video dialtone services are still evolving. As a result, we here clarify that we will be vigilant in our efforts to identify possible anticompetitive conduct in connection with video dialtone offerings. Further, we note that we are prepared to impose additional safeguards tailored to specific video dialtone proposals in connection with the specific Section 214 certification process if necessary . . .[8]

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[5] Telephone Company-Cable Television Cross-Ownership Rules, Further Notice of Proposed Rulemaking, 7 F.C.C.R. 300, 321 (1991).

[6] Id.

[7] See Telephone Company-Cable Television Cross-Ownership Rules, Second Report and Order, 7 F.C.C.R. 5781, 5824-5626 (1992) ("VDT Order").

[8] Id. at 5832.

The FCC announced that Section 214 proceedings would henceforth become the forum for such considerations.

> [W]e intend to reassess the adequacy of our existing safeguards at such time as local telephone companies present us with specific video dialtone proposals in connection with a Section 214 authorization.[9]

Indeed, while many prospective providers of VDT asked the FCC to streamline the Section 214 authorization process, the Commission, cognizant of the role Section 214 would play in VDT, declined:

> Because we believe that the Section 214 process plays an important role in our ability to ensure that the risk of anticompetitive conduct is minimized, we decline to streamline or eliminate as unnecessary the present Section 214 certification requirement. See FNOI, 3 FCC Rcd at 5862 (Section 214 requirement provides a mechanism for assuring compliance with cross-ownership policies).[10]

The Commission decided that it would consider establishing VDT rules in individual Section 214 proceedings. It proposed, in essence, a piecemeal approach in which each Section 214 application would form a precedent in a growing body of VDT jurisprudence. The resulting body of rules and regulations would shape the manner in which telcos constructed the national information infrastructure. It would also determine the manner in which telephone ratepayers would be protected from unfairly subsidizing that construction.

These important issues were at stake when the Commission reviewed the Dover Section 214 application, the first commercial application and therefore potentially the most important VDT

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[9] Id. at 5827.

[10] Id. at 5827 n.231.

precedent. Before the FCC issued its decision on the Dover Section 214 application, the Consumer Federation of America and NCTA filed a Joint Petition for Rulemaking[11] in which the petitioners asked the Commission to commence a comprehensive rulemaking proceeding to establish VDT-specific allocation and cross-subsidy protections.[12] In addition, the Joint Petition called for the establishment of a Federal-State Joint Board to recommend procedures for separating the costs of local telephone service and VDT.[13] The Commission deferred consideration of the Joint Petition, however, until after issuing the Dover Section 214 Order.[14]

Moreover, rather than address the potential allocative problems with VDT in the Dover Section 214 Order, the Commission avoided the issue. In a decision that eviscerated the value of the economic viability showing required by Section 63.01(m) of the Commission's rules,[15] the Commission held in the Dover Section 214 Order that Section 214 applicants must only provide information regarding the "added" or "incremental" costs and

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[11] See Joint Petition for Rulemaking and Request for Establishment of a Joint Board, filed by the Consumer Federation of America and NCTA (April 8, 1993) ("Joint Petition").

[12] See id. at 14-22.

[13] See id. at 11-13.

[14] See Application of New Jersey Bell Telephone Company, Order and Authorization, 9 F.C.C.R. 3677 (1994)("Dover Section 214 Order").

[15] See 47 C.F.R. § 63.01(m).

revenues for VDT and nothing regarding the common costs of VDT.[16] Under this standard, therefore, Section 214 applicants were not required to demonstrate that VDT revenues would cover the total cost of providing VDT service. The regulatory approval processes notwithstanding, no one should dispute the proposition that to avoid cross-subsidy revenues must exceed total costs. The only controversy is over whether the particular allocation scheme selected will achieve this end.

Having thus avoided any real decision in the Section 214 context, the Commission had yet another opportunity to address the allocation issue in the VDT Reconsideration Order.[17] Instead of adopting the rules recommended in the Joint Petition,[18] however, the Commission once again acknowledged the seriousness of the issue only to choose not to address it:

> We are committed to implementing video dialtone in a manner that does not subject basic telephone ratepayers to unreasonable rate increases or allow improper cross-subsidization. We do not, however, agree that ratepayer protection requires that this Commission adopt comprehensive, video dialtone-specific accounting and cost allocation rules before authorizing video

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16 See Dover Section 214 Order, 9 F.C.C.R. at 3682-3684.

17 See Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58 and Amendments to Parts 32, 36, 61, 64, and 69 of the Commission's Rules, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 F.C.C.R. 244 (1994)("Reconsideration Order").

18 Again, although the Joint Petition was filed on April 8, 1993, the Commission did not respond to it until it issued the Reconsideration Order on November 7, 1994.

dialtone services.[19]

It is now four years since the Commission explicitly acknowledged the seriousness of the allocation issue in the VDT Further Notice of Proposed Rulemaking, and still a coherent framework does not exist for the allocation of the costs of VDT. The Commission did establish in the Reconsideration Order more elaborate cost support requirements for VDT tariffs than apply to most other telephone company services.[20] But it must do much more than require cost support information. It must make a policy decision as to who will bear the cost of this VDT upgrade. It must also ensure that the particular costs of the Dover system are allocated in accordance with that decision. These issues can no longer be deferred.

II. BELL ATLANTIC'S PROPOSED RATES FOR ITS DOVER VDT SERVICE ARE UNLAWFUL AND SHOULD BE ADJUSTED TO REFLECT THE COSTS OF THE SERVICE.

Section 201(b) of the Communications Act requires that the

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[19] Id. at 322. While the Commission has adopted a price cap basket for video dialtone, the agency has sided with the telephone companies and declined to establish VDT-specific jurisdictional separations, access charge, joint marketing and customer privacy procedures. Aside from the cross-subsidy concerns, customer privacy rules are especially important given that the Chairman of Bell Atlantic recently told a national television audience that the company intends to use information regarding subscriber-specific viewing habits to target market products to television viewers. See Appendix B at 4-5. By contrast, it is unlawful for cable operators to collect subscriber information without their consent for any purpose unless the information is necessary either (a) to provide a service provided by the cable operator to the subscriber or (b) to detect unauthorized reception of cable communications. See 47 U.S.C. § 551(b).

[20] See Reconsideration Order, 10 F.C.C.R. at 344-346.

Commission ensure that rates charged for interstate common carrier services, including VDT, are just and reasonable.[21] A carrier whose new charge for a common carrier service is subject to an investigation bears the burden of proving that such rate is just and reasonable.[22] The Commission has interpreted the terms "just and reasonable" in the context of new service offerings[23] to mean that "a price is unreasonably low if it is predatory; a predatory price is one that does not recover the incremental costs of providing a service."[24] Moreover, in the Reconsideration Order, the Commission stated that VDT providers must make "a reasonable allocation [to VDT] of other costs that are associated with shared plant used to provide video dialtone and other services."[25] The Commission also stated that VDT

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[21] See 47 U.S.C. § 201(b).

[22] See 47 U.S.C. § 204(a)(1) ("At any hearing involving a new or revised charge, or a proposed new or revised charge, the burden of proof to show that the new or revised charge, or proposed charge, is just and reasonable shall be upon the carrier . . ."); Nader v. FCC, 520 F.2d 182, 198 (D.C. Cir. 1975) ("Under section 204, the carrier has the burden of proving that the rates or practices being investigated are 'just and reasonable'").

[23] The Commission decided to apply the new services test to VDT in the Reconsideration Order. See Reconsideration Order, 10 F.C.C.R. at 340.

[24] Id. at 343. See also Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking (released September 20, 1995) at ¶ 41 (new services test designed to prevent below cost predatory pricing).

[25] Reconsideration Order, 10 F.C.C.R. at 345 (explaining further that "we do not anticipate accepting a 0% allocation of the common costs of shared plant as reasonable"). Dr. Johnson describes these costs at page 28 of his Declaration in the category he labels "Other Shared Plant."

providers would be required to allocate a reasonable portion of overhead costs to VDT.[26]

The total estimated construction cost of Bell Atlantic's integrated network is $68.4 million, or $1,785 per potential subscriber.[27] Bell Atlantic proposes to assign 67% of this cost, or $1,191 per potential subscriber, to telephony (excluding switching) and the remaining 33%, or $594 per potential subscriber, to video.[28] As demonstrated in Dr. Johnson's Declaration, Bell Atlantic has failed to show that this allocation is reasonable.

Specifically, under Bell Atlantic's tariff, the telephone portion of the VDT facility costs more than replacing the existing telephone network with a new stand-alone facility. The company has also failed to show why overhead costs are not in fact incremental. It follows that the Commission should not permit Bell Atlantic the discretion to choose at random some portion of overhead to allocate to VDT. Instead, the company should be required to allocate to VDT all overhead costs that are incremental to that service.

Dr. Johnson concludes on the basis of his cost analysis that Bell Atlantic's tariff rates for Broadcast Channel Service, both

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[26] See id. at 346. Since the Commission understood overhead costs as non-incremental costs, it stated only that it "would not anticipate accepting a 0% allocation of overhead as reasonable." Id. As explained below, however, overhead costs are in fact incremental.

[27] See Johnson Declaration at 5.

[28] See id.

month-to-month and five-year contract, would have to be 75% and 83% higher respectively to cover even the incremental costs of those services. To recover a reasonable portion of fixed costs (and only the "other shared plant" costs can be reasonably understood as "fixed"), rates for both services would have to be more than 100% higher.

Bell Atlantic has therefore failed to meet its burden of proving that its proposed rates for VDT recover the incremental costs of providing the service as well as a reasonable portion of fixed shared plant costs. In accordance with its authority under Section 205 of the Communications Act,[29] the Commission must therefore prescribe rates for Dover that cover the full cost of providing VDT service.

A. BELL ATLANTIC HAS FAILED TO DEMONSTRATE THAT THE TELEPHONE PORTION OF THE DOVER FACILITY SHOULD COST MORE THAN A STAND-ALONE TELEPHONE FACILITY.

As stated, Bell Atlantic allocates $1,191 per subscriber of the cost of the Dover upgrade to telephony. Dr. Johnson estimates that the incremental cost of upgrading the existing telephone network to expand the available offerings would amount to $308 per subscriber line.[30] Alternatively, he estimates that the cost of replacing the existing network with a digital loop

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[29] See 47 U.S.C. § 205(a) (granting FCC the power to prescribe just and reasonable rates for common carrier services).

[30] See Johnson Declaration at 6. This figure is an estimate based on a recent New England Telephone cost study report of the cost of upgrading the existing telephone network. See id. at 6. It is not intended to represent the exact cost of upgrading the existing telephone network in Dover.

carrier system is about $700 per subscriber line.[31] Bell Atlantic's purported cost of the telephone portion of the Dover upgrade therefore exceeds the cost of either upgrading the existing narrowband network or constructing a new stand-alone telephone network.

Dr. Johnson shows that Bell Atlantic has failed, indeed hardly even attempted, to meet its burden of proving that the telephone service offered over the Dover facility has caused costs of the magnitude attributed to that service. First, it has failed to show that the narrowband portion of the Dover network will have greater capabilities than a digital loop carrier system or even an upgraded existing network.[32] It is far from clear, for example, that the Dover upgrade can be reasonably understood as simply the next logical upgrade in the telephone network that will lead to as yet unknown innovative services in the future.[33]

Moreover, it is particularly important that Bell Atlantic

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[31] See id. at 6-7. This figure is also intended as a representative estimate of the cost of replacing the existing telephone network with a new digital loop carrier system. Dr. Johnson arrives at the $700 figure by averaging the results of two studies of the cost of constructing such a network. See id. citing David P. Reed, Residential Fiber Optics Networks, An Engineering and Economic Analysis, Artech House (1992) at 288-289 and Hatfield Associates, Inc., The Cost of Basic Universal Service (July 1994).

[32] See id. at 7-11.

[33] Bell Atlantic seems to have asserted that this is the way the Dover network should be understood. See Reply of Bell Atlantic to NCTA's Petition to Reject, or in the alternative, to Suspend and Investigate Bell Atlantic's VDT Tariff for the Dover System, Tariff F.C.C. No. 10 (March 6, 1995) at 9. Dr. Johnson refers to this assertion at page 8 of his Declaration.

identify specific telephone services it will provide over the Dover network that are not deliverable over a different, less expensive network. As Dr. Johnson puts it, the relevant question is as follows:

> [H]ow does extension of fiber all the way to the curb, instead of to a neighborhood node (the digital loop carrier architecture), sufficiently enhance the capability of the network for narrowband applications to justify a cost assignment to telephony far in excess of the cost of building an entirely separate narrowband system?[34]

Bell Atlantic fails to answer this question. As Dr. Johnson explains, the portion of the network used for the "voice" or "telephony/other" services described in the Dover Direct Case is limited to the kind of narrowband transmission offered on the current network.[35] It is not surprising, then, that many of the specific services that Dr. William E. Taylor, in an Affidavit attached to the Dover Direct Case,[36] claims will be available on the Dover facility (packet switching, ISDN services, private line) are available on either an upgraded version of the current network or on a digital loop carrier design.[37] The remaining services Dr. Taylor lists as purportedly available on the Dover facility will be provided over the video portion of the network (high-speed data, interactive information services and VDT

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[34] Johnson Declaration at 10.

[35] See id. at 11.

[36] See Bell Atlantic Direct Case, Introduction and Summary ("Dover Direct Case"), Affidavit of William E. Taylor, Ph.D. ("Taylor Affidavit").

[37] See Johnson Declaration at 14.

services).[38]

The only "new" service to be provided over the telephone portion of the Dover network is something Dr. Taylor calls "broadband" telephony.[39] As Dr. Johnson observes, it is unclear what Dr. Taylor means by this, although it is most likely some advanced version of the notoriously unsuccessful picturephone service. Dr. Johnson states, however, that the Dover narrowband network, as currently conceived, could not support this service and would require enormous further investment for it to do so.[40] Even assuming a demand for such services, therefore, "broadband" telephony cannot be offered on the Dover network without burdening telephone subscribers even more than they already are under Bell Atlantic's Dover plan. What is more, the revenue from any such service would have to cover not just the costs it causes, but also the difference between the costs Bell Atlantic assigns to the Dover narrowband plant and the stand-alone alternative.

Finally, Dr. Johnson shows that Bell Atlantic's assertion that the new Dover architecture will have lower maintenance costs than traditional copper networks is misleading.[41] Presumably, Bell Atlantic is trying to show that some of the costs allocated to telephony will be offset by lower maintenance costs. In fact,

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38 See id. at 14-15.

39 See Taylor Affidavit at 12.

40 See Johnson Declaration at 12.

41 See id. at 17-19.

however, there is nothing in the Direct Case to show that the Dover maintenance costs will be any lower than those of an upgraded existing plant or a digital loop plant. Bell Atlantic chooses instead to attack a straw man -- maintenance costs on the traditional copper network -- probably because there are no increased maintenance efficiencies created by fiber to the curb over less expensive alternatives.

All of this means that, based on the information in the Direct Case, Bell Atlantic has failed to demonstrate that its allocation of the costs of the Dover upgrade to telephony are reasonable. Thus, without even considering overhead costs, Bell Atlantic has underallocated costs to telephony by more than 50% (the difference between the $700 cost of the stand alone network and the $1,191 attributed to telephone services in the Dover Direct Case).

B. OVERHEAD COSTS MUST BE TREATED AS INCREMENTAL NOT FIXED.

Bell Atlantic allocates a 20% loading factor to VDT. This loading factor would be unreasonably low even if, as Bell Atlantic asserts, overhead costs were variable and therefore not incremental. As Dr. Johnson explains, however, overhead costs are in fact variable and <u>incremental</u>. This means that Bell Atlantic should not have the discretion to randomly choose some proportion of its overhead costs for allocation to VDT. Rather, Bell Atlantic must allocate all overhead costs to VDT that are incremental to that service. Indeed, the only costs for which Bell Atlantic has the discretion simply to choose a reasonable proportion for allocation to VDT are the "other" shared plant costs mentioned above.

As demonstrated in Table 4 of Dr. Johnson's Declaration, overhead costs grow in roughly the same proportion as the direct costs of all services.[42] Since Bell Atlantic assigns an overhead rate of 65% of direct costs, the incremental overhead of VDT, like any other service, should be 65% of the direct costs of that service. Dr. Johnson concludes that the Commission should require that each dollar of direct investment in video be given a 65% overhead loading rather than, as Bell Atlantic suggests, a 20% overhead loading.[43] To handle overhead in any other way would be to authorize Bell Atlantic to charge rates for VDT that are below incremental cost.[44]

C. THE DOVER TARIFF RATES FOR VDT SERVICES FAIL TO RECOVER THE COSTS OF THE SERVICES.

Dr. Johnson concludes that the Dover tariff rates for VDT services would have to be increased significantly in order to recover the true incremental cost of these services and a reasonable allocation of fixed shared plant costs. To demonstrate this point, Dr. Johnson focuses on Bell Atlantic's tariff rates for month-to-month and five-year Broadcast Channel

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42 See Johnson Declaration at 25.

43 See id. at 24-25.

44 As Dr. Johnson further points out, Dr. Taylor's response that any loading higher than 20% would "require VDT services to recover more of the overhead costs than VDT market conditions permit" amounts to an admission that Bell Atlantic's VDT service is only viable at significantly subsidized rates. Id. at 26.

Services. He analyzes the portion of each of the five cost categories listed in the Direct Case[45] that are included in the broadband portion of the VDT network and assumes that the incremental cost of the telephone portion equals the cost of replacing it with a digital loop network.[46] Dr. Johnson concludes that Bell Atlantic would have to raise its rates for month-to-month and five-year Broadcast Channel Service by 75% and 83% respectively in order to cover even the incremental cost of providing the services.[47] Moreover, he concludes that Bell Atlantic would have to raise its VDT rates by more than 100% to recover a reasonable portion of the fixed shared plant costs of the facility.[48]

Bell Atlantic has therefore completely failed to meet its burden of demonstrating that its rates for VDT recover the incremental cost plus a reasonable allocation of fixed shared plant costs as required by the new services test as applied in the Reconsideration Order. The Commission must accordingly prescribe rates for Dover that do recover these costs.

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45 The five categories are (1) primary plant investment, (2) incremental costs of shared primary plant investment, (3) other shared plant, (4) maintenance, administration and other costs, and (5) overhead.

46 As Dr. Johnson points out, if it is assumed that the incremental cost of the telephone portion equaled the cost of upgrading the existing network, VDT rates would have to be increased even further to cover incremental costs.

47 See id. at 30-31.

48 See id. at 29.

D. PRICE CAP REGULATION DOES NOT ELIMINATE THE OPPORTUNITY AND INCENTIVE FOR CROSS-SUBSIDIZATION.

Bell Atlantic maintains that, despite any allocative problems with its tariff, the company has no incentive or ability to cross-subsidize under the FCC and New Jersey price cap schemes. As Dr. Johnson demonstrates, this is simply not the case.

Under the New Jersey price cap regime, there remains a strong tie between costs and prices. First, under that scheme, Bell Atlantic is not subject to the 2% state productivity factor if its rate of return falls below 11.7% in the preceding year.[49] As Dr. Johnson points out, the telco has the incentive to shift the costs of VDT onto intrastate telephone services if doing so reduces the intrastate rate of return below 11.7% and denies telephone ratepayers the benefit of the productivity factor.

Second, the New Jersey price cap plan requires that Bell Atlantic share equally with subscribers any amount it makes in excess of a 13.7% rate of return. This provision gives Bell Atlantic the incentive to shift VDT costs onto the intrastate telephone rate base if doing so lowers the rate of return below 13.7% and denies local subscribers the benefit of sharing.[50]

Finally, New Jersey is scheduled to review the productivity rate for telephone services after 1999. If Bell Atlantic shifts video costs onto the intrastate telephone rate base before then,

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[49] See id. at 32.

[50] See id.

New Jersey will likely establish a lower productivity factor for the period after 1999 than if the telco had not padded its telephone rate base. Once again, therefore, the New Jersey price cap scheme creates the incentive to cross-subsidize VDT.[51]

The FCC's price cap scheme also offers Bell Atlantic the opportunity and incentive to cross-subsidize the cost of VDT. This is so despite the fact that Bell Atlantic has chosen an X-Factor under which it is exempt from the sharing and lower end adjustment mechanisms. For example, the X-Factor is periodically adjusted to ensure that LEC rates of return do not exceed levels that regulators view as just and reasonable. This process gives Bell Atlantic the incentive to shift VDT costs onto its interstate telephone rate base to lower its historic rate of return.[52]

Therefore, both the New Jersey and the FCC price cap schemes give Bell Atlantic the incentive and opportunity to cross-subsidize the costs of VDT. Bell Atlantic's reliance upon price caps as a panacea for the misallocation of its Dover VDT service is simply misplaced.

III. BELL ATLANTIC HAS FAILED TO ADDRESS OTHER SERIOUS DEFECTS IN ITS DOVER DIRECT CASE.

A. BELL ATLANTIC'S VOLUME AND TERM DISCOUNTS FOR VDT SERVICE ARE UNREASONABLE.

In the Designation Order the Commission required Bell Atlantic to demonstrate that its volume and term discounts were

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[51] See id.

[52] See id. at 33.

not unduly discriminatory.[53] The Commission also required Bell Atlantic to explain why it has not offered discounts for terms of shorter duration.[54]

Bell Atlantic defends its five year requirement by asserting that any programmer is eligible for such a discount and, moreover, companies obtaining such discounts can resell to smaller programmers.[55] As a fallback, Bell Atlantic asserts that if bona fide demand develops for shorter term discounts, it will of course offer them.[56]

NCTA believes that offering discounts only to programmers able to commit to five years unduly discriminates against less established programmers unable to make substantial up front commitments. Nor is it particularly likely that smaller programmers will indirectly benefit from the discounts through the resale market. Unlike VDT providers, resellers are not subject to common carrier obligations, and they will obviously favor established, well-financed programmers over smaller operations. The result is that the Commission goal of fostering increased diversity in the video programming available to the public will be undermined. The Commission should therefore require Bell Atlantic to offer cost-justified discounts for periods significantly shorter than five years.

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53 See Designation Order at ¶ 46.

54 See id.

55 See Dover Direct Case at 89-90.

56 See id. at 92.

B. BELL ATLANTIC'S LIABILITY PROVISIONS FOR EARLY TERMINATION OF SERVICE AGREEMENTS ARE UNREASONABLE.

The discriminatory nature of Bell Atlantic's volume and term discount policy is only compounded by its liability provisions for early termination of service agreements. In the Designation Order, the Commission reiterated its concern as to the reasonableness of the tariff provisions regarding (a) 100% liability for early termination, (b) the limitation on the ability of programmers to cancel service if Bell Atlantic fails to deliver adequate service and (c) the 90 day limit for programmers to find replacement programmers and mitigate the damage to Bell Atlantic.[57] It therefore asked Bell Atlantic to justify these terms.

In response, Bell Atlantic essentially states that it is in its best business interests to maintain these provisions.[58] It does not attempt to address the discriminatory effect of these terms and conditions. Yet that is exactly the problem. The effect of all of these provisions could well be to make it too risky for all but Bell Atlantic's affiliated programmers to take advantage of the five year discounts.[59] The price for early termination, which applies even if caused by poor Bell Atlantic

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[57] See Designation Order at ¶¶ 48-51.

[58] See Dover Direct Case at 93-101.

[59] It is NCTA's understanding that Bell Atlantic currently holds an ownership interest as well as an option to increase that ownership interest in Futurevision, one of the programmers on the Dover VDT platform. If this is untrue, Bell Atlantic should so state on the record.